

## Message Text

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ACTION EUR-12

INFO OCT-01 ISO-00 AID-05 CEA-01 CIAE-00 COME-00 EB-08  
EA-07 FRB-03 INR-07 IO-13 NEA-10 NSAE-00 USIA-06  
OPIC-03 SP-02 TRSE-00 CIEP-01 LAB-04 SIL-01 AGRE-00  
OMB-01 SS-15 NSC-05 PA-01 PRS-01 L-03 H-01 /111 W  
-----242019Z 026510 /40

R 241950Z JAN 77  
FM USMISSION OECD PARIS  
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INFO AMEMBASSY PARIS

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PASS CEA, TREASURY, FRB

E.O.11652: N/A  
TAGS: ECON, OECD  
SUBJECT: ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC)  
REVIEW OF FRANCE

REFS: (A) EDR(77)2, (B) STATE 9338, (C) OECD PARIS 0819

1. SUMMARY: AT JANUARY 18 EDRC REVIEW OF FRANCE, FRENCH DEL (LED BY CORTESSE, MINISTRY OF FINANCE) GAVE DETAILED EXPOSITION OF RATIONALE UNDERLYING GOF PROJECTIONS (CONTAINED IN BUDGET FOR 1977) OF EVOLUTION OF FRENCH ECONOMY IN 1977. CORTESSE CHARACTERIZED THESE "PROJECTIONS" AS NORMATIVE, BEST-OUTCOME SCENARIO ILLUSTRATING EFFECTS OF ACHIEVING ALL TARGETS SET UNDER BARRE PLAN, RATHER THAN AS "MAXIMUM LIKELIHOOD" OUTCOME WHICH COULD BE COMPARED DIRECTLY TO SECRETARIAT'S (MORE PESSIMISTIC) FORECASTS. WHILE IMPLYING THAT ACTUAL FRENCH PERFORMANCE IN 1977 MIGHT NOT TURN OUT AS ENVISAGED IN BARRE PLAN, FRENCH STOPPED SHORT OF ADMITTING THAT SECRETARIAT FORECASTS WOULD BE CLOSER TO MARK THAN WOULD GOF PROJECTIONS.

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DESPITE DIFFERING ESTIMATES FOR DOMESTIC VARIABLES AND FOR GROSS TRADE FLOWS, SECRETARIAT AND GOF SURPRISINGLY AGREED ON LIKELY CURRENT ACCOUNT OUTCOME IN 1977. FRENCH AND SECRETARIAT ALSO AGREED ON ESSENTIAL POINTS THAT (A) AUSTERITY MEASURES ADOPTED IN SEPTEMBER 1976 WERE NECESSARY TO ARREST DETERIORATION OF ECONOMIC SITUATION; (B) THESE MEASURES WILL LEAD TO SLOWER GROWTH IN

1977, BUT WILL ALSO ENTRAIN DECELERATION OF INFLATION RATE, AND REDUCTION OF CURRENT ACCOUNT DEFICIT, AND (C) IN ORDER TO CREATE CONDITIONS NECESSARY FOR SUSTAINABLE GROWTH OVER MEDIUM TERM, GOF MUST MAINTAIN UNWAVERING COMMITMENT TO ATTAINMENT OBJECTIVES SET UNDER BARRE PLAN. IN ADDITION, FRENCH NOTED THAT THEIR PROGRAM IMPLIED UNCHANGED EXCHANGE RATE FOR FRANC AND THAT RATE DEPRECIATION DURING 1976 HAD GIVEN THEM MARGIN OF COMPETITIVITY WHICH MADE THIS ASSUMPTION REALISTIC. STABILITY OF FRANC PRIORITY OBJECTIVE WHICH "BOTH DESIRABLE AND POSSIBLE." FRENCH DID NOT EXPECT TO ENCOUNTER PROBLEMS IN FINANCING PROJECTED 1977 CURRENT ACCOUNT DEFICIT (\$3.5 - \$3.8 BILLION), NOR DID THEY VIEW MOUNTING EXTERNAL DEBT AS SERIOUS PROBLEM. NEVERTHELESS, THEY SAW NEED TO EFFECT FURTHER REDUCTIONS IN CURRENT ACCOUNT DEFICIT AS CONSTITUTING IMPORTANT SHORT-RUN CONSTRAINT ON GROWTH. THEY WELCOMED INDICATIONS THAT U.S. WOULD SHORTLY IMPLEMENT STIMULATIVE MEASURES, STATED THIS PROSPECT STRENGTHENED LIKELIHOOD FRENCH OBJECTIVES RATHER THAN SECRETARIAT'S PROJECTIONS FOR 1977 WOULD BE REACHED, AND EXPRESSED HOPE THAT OTHER STRONG OECD COUNTRIES (E.G. FRG) WOULD FOLLOW SUIT. END SUMMARY.

2. SHORT-TERM PROSPECTS; DOMESTIC OUTLOOK: WHILE NOTING THAT PROJECTIONS CONTAINED IN 1977 BUDGET OF EVOLUTION IN 1977 OF MAIN COMPONENTS OF DOMESTIC DEMAND WERE NORMATIVE IN SENSE THAT THEY OUTLINE MACRO-ECONOMIC IMPLICATIONS OF ACHIEVING ALL OBJECTIVES OF BARRE PLAN, FRENCH ARGUED THAT THESE PROJECTIONS WERE NOT ONLY LIMITED OFFICIAL USE

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INTERNALLY CONSISTENT, BUT COULD CONCEIVABLY BE ACHIEVED, AND THAT SECRETARIAT FORECASTS WERE OVERLY PESSIMISTIC. THEY, HOWEVER, DID NOT FLATLY DENY THAT SECRETARIAT'S PROJECTIONS MIGHT NOT TURN OUT TO BE RIGHT. FRENCH EXPLAINED THAT GOF PROJECTION OF 4 PERCENT INCREASE IN REAL PRIVATE CONSUMPTION IS BASED ON 10-11 PERCENT INCREASE IN SALARIES, 15 PERCENT RISE IN TRANSFER INCOME WHICH, CONSIDERING SMALL EXPECTED RISE IN DIRECT TAXATION AND PROJECTED 8 PERCENT RISE IN CPI, YIELDS 12 PERCENT RISE IN NOMINAL DISPOSABLE INCOME AND 4 PERCENT GROWTH OF REAL DISPOSABLE INCOME. EDRC DISCUSSION REVEALED (CONTRARY TO SECRETARIAT STATEMENT REFD0C) THAT VARIANCE BETWEEN SECRETARIAT AND FRENCH PROJECTIONS OF PRIVATE CONSUMPTION IS NOT TRACEABLE PRIMARILY TO FACT THAT FRENCH (UNLIKE SECRETARIAT) EXPECT DROP IN SAVINGS RATIO, SINCE GOF PROJECTION IMPLIES VIRTUAL STABILITY OF THIS VARIABLE (I.E. FALL FROM 16.3 PERCENT TO 16.1 PERCENT BETWEEN 1975 AND 1976). RATHER, SECRETARIAT AND FRENCH AGREED THAT DIVERGENCE IN FORECASTS

OF REAL PRIVATE CONSUMPTION WERE MOSTLY ATTRIBUTABLE

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EA-07 FRB-03 INR-07 IO-13 NEA-10 NSAE-00 USIA-06  
OPIC-03 SP-02 TRSE-00 CIEP-01 LAB-04 SIL-01 AGRE-00  
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TO DIFFERENCE IN PROJECTED INCREASE IN CONSUMER PRICES  
(SECRETARIAT FORECASTS 8.75 PERCENT; FRENCH, 8 PERCENT).

3. FRENCH CITED FOLLOWING REASONS WHY SECRETARIAT COULD  
WELL BE TOO BEARISH ON OUTLOOK FOR INVESTMENT SPENDING  
IN 1976: (A) FIRMS' ORDERS FOR INVESTMENT GOODS ARE  
RUNNING HIGHER THAN PREVIOUSLY EXPECTED; (B) REAL  
PUBLIC INVESTMENT COULD INCREASE BY 10 PERCENT; (C)  
FINANCIAL SITUATION OF FIRMS HAS IMPROVED IN 1976 AND  
WILL CONTINUE TO DO SO IN 1977 IF REAL GDP GROWTH IS  
BETWEEN 4 AND 5 PERCENT; (D) TARGET (12.5 PERCENT) FOR  
GROWTH OF M2 IN 1977 NOT LIKELY TO CREATE CREDIT CONDI-  
TIONS DETRIMENTAL TO INVESTMENT; (E) 1977 BUDGET PRO-  
VIDES FOR ADDITIONAL SUPPORT SHOULD INVESTMENT SPENDING  
FALTER DURING YEAR. FRENCH ALSO CITED SURVEY RESULTS  
WHICH INDICATED THAT FIRMS ARE CURRENTLY OPERATING ONLY  
ABOUT 10 PERCENT BELOW DESIRABLE CAPACITY (7 PERCENT  
BELOW CAPACITY CONSIDERED BY BUSINESSMEN TO BE "FULL CAPACITY"  
UTILIZATION), IMPLYING THAT EXISTENCE OF SUBSTANTIAL  
EXCESS CAPACITY MIGHT NOT BE IMPORTANT FACTOR IMPEDING  
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GROWTH OF PRIVATE INVESTMENT THIS YEAR. SECRETARIAT LISTENED PATIENTLY TO FRENCH ARGUMENTATION, BUT DID NOT SEEM INCLINED TO MODIFY ITS FORECASTS FOR DECLINE IN PRIVATE INVESTMENT LEADING TO MODEST (1.5 PERCENT) INCREASE IN GROSS FIXED CAPITAL FORMATION IN 1977.

4. IMPORTANT DIFFERENCE BETWEEN SECRETARIAT AND FRENCH VIEW OF 1977 OUTLOOK LAY IN EXPECTED PATTERN OF GDP GROWTH DURING YEAR. FRENCH FORESEE SLOW GROWTH IN FIRST HALF OF 1977 AND ACCELERATION THEREAFTER, COMPARED WITH SECRETARIAT FORECASTS OF GDP GROWTH OF 3 PERCENT AND OF 2-3/4 PERCENT RESPECTIVELY FOR THESE TIME PERIODS. SECRETARIAT NOTED THAT ACCEPTANCE BY FRENCH OF SECRETARIAT FORECASTS FOR 1976 AND FIRST HALF OF 1977 WOULD IMPLY THAT FRENCH GDP WOULD HAVE TO GROW AT 8 PERCENT ANNUAL RATE IN SECOND HALF OF YEAR FOR GOF PROJECTIONS (4-5 PERCENT) OF YEAR-ON-YEAR GROWTH RATE TO BE REALIZED. SECRETARIAT ARGUED THAT FACTORS WHICH WOULD GENERATE SUCH AN ACCELERATION WERE HARD TO IDENTIFY. FRENCH DID NOT TAKE SHARP ISSUE WITH SECRETARIAT REASONING, BUT EXPLAINED THAT BARRE PLAN SHOULD BE SEEN AS TWO-STAGE PROCESS: A LOW-GROWTH PHASE (FIRST HALF OF 1977), IN WHICH PRIMARY OBJECTIVE WOULD BE TO ESTABLISH CONDITIONS FOR SUSTAINED EXPANSION BY REDUCING INFLATION AND IMPROVING CURRENT ACCOUNT; AND SECOND PHASE (SECOND HALF OF 1977) CHARACTERIZED BY ACCELERATION OF GDP GROWTH. IN THIS CONNECTION, FRENCH (BERNARD) POINTED TO INCONSISTENCY BETWEEN SECRETARIAT FORECASTS AND POLICY RECOMMENDATIONS -- SECRETARIAT FORECASTS IMPLIED THAT TARGETS OF BARRE PLAN WOULD NOT BE ATTAINED IN 1977, BUT SECRETARIAT'S POLICY RECOMMENDATIONS DID NOT SUGGEST THAT GOF POLICIES WERE INADEQUATE. SECRETARIAT AGREED THAT BARRE PLAN POLICIES WERE RIGHT, BUT WAS LESS OPTIMISTIC CONCERNING TIMING OF SALUTORY EFFECTS OF AUSTERITY MEASURES, AND THUS FELT THAT LOW-GROWTH PHASE COULD EXTEND INTO SECOND HALF OF 1977. SECRETARIAT ADDED THAT QUESTION OF TIMING

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ALSO EXPLAINED APPARENT INCONSISTENCY BETWEEN ITS FORECASTS AND POLICY RECOMMENDATIONS.

5. PRICES AND WAGES: BARRE PLAN CALLS FOR 6.5 PERCENT INCREASE IN CONSUMER PRICES DURING 1977 AND 8 PERCENT AVERAGE RISE FOR YEAR AS WHOLE. FRENCH POINTED TO SEVERAL FACTORS CONDUCIVE TO ATTAINMENT OF THIS OBJECTIVE. THESE INCLUDED THE FOLLOWING: (A) POLICY OF

STRICT PRICE SURVEILLANCE WILL BE EFFECTIVE FOLLOWUP TO  
PRICE FREEZE WHICH ENDED JANUARY 1, 1977; (B) PURSUANT  
TO THIS POLICY, FIRMS IN INDUSTRIAL AND SERVICE SECTOR  
HAVE BEEN- ENGAGED IN "COMMITMENTS TO MODERATION"  
(ALTHOUGH FORMAL SANCTIONS NOT PRESENTLY PROVIDED FOR,  
FRENCH INDICATED THAT MEANS READILY AVAILABLE TO COUNTER  
IRRESPONSIBLE PRICE BEHAVIOR); (C) GROSS RETAIL MARGINS  
CONTINUE TO BE FROZEN; (D) PRICES OF GOVERNMENT SER-  
VICES WILL REMAIN FROZEN UNTIL APRIL 1977; (E) ASSUMING  
GOALS OF BARRE PLAN ARE MET, WAGE INCREASES SHOULD NOT  
CONTRIBUTE TO INFLATION IN 1977. (BARRE PLAN SETS  
2 PERCENT INCREASE IN REAL AVERAGE HOURLY WAGE RATES;  
FRENCH PROJECT 5 PERCENT INCREASE IN PRODUCTIVITY IN  
1977 COMPARED WITH THEIR ESTIMATES OF 4.3 PERCENT AND  
6.6 PERCENT INCREASE RESPECTIVELY IN WAGE RATES AND  
PRODUCTIVITY IN 1976); (F) STRINGENT MONETARY POLICY  
WILL LIMIT FIRMS' ABILITY TO BORROW IN ORDER TO PAY  
EXCESSIVE WAGE INCREASES OR TO PASS ON COST INCREASES  
INTO PRICES; (G) WAGE INCREASES ACCORDED TO PUBLIC-  
SECTOR EMPLOYEES WILL HAVE IMPORTANT DEMONSTRATION

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EFFECT ON PRIVATE SECTOR, AND GOF CAN HAVE DIRECT  
MODERATING INFLUENCE IN THIS AREA; (H) CONJUNCTURAL  
LEVY ON FIRMS SHOULD ACT TO DETER PRICE INCREASES, AND

(I) FRANC WILL NOT DEPRECIATE.

6. U.K. SUGGESTED THAT HIGH UNEMPLOYMENT COULD LEAD LABOR TO CONCLUSION THAT MODERATION HAD LITTLE PAY-OFF IN TERMS OF INCREASED EMPLOYMENT, WITH RESULT THAT WAGE CLAIMS COULD RISE SHARPLY. FRENCH RESPONDED THAT IN FORMULATING WAGE CLAIMS, LABOR WAS MORE INFLUENCED BY PRICE DEVELOPMENTS THAN BY SUPPLY/DEMAND BALANCE IN LABOR MARKET. HAVING RECITED ABOVE LITANY, THEY ACKNOWLEDGED DANGER THAT WAGE/PRICE SPIRAL COULD DEVELOP IN 1977 WITH RESULT THAT SECRETARIAT PRICE FORECAST (8.75 PERCENT) OR WORSE, WOULD BE ACTUAL OUTCOME.

7. LIKE SECRETARIAT, FRENCH EXPECT CONTINUED WEAKNESS IN LABOR MARKET IN 1977. FRENCH ADDED, HOWEVER, THAT RELATIVELY HIGH LEVEL OF UNEMPLOYMENT WOULD NOT BE THE POLITICAL DISASTER IT MIGHT HAVE BEEN FIVE YEARS AGO  
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DUE TO INCREASED UNEMPLOYMENT COMPENSATION AND TO FACT THAT MANY JOB-SEEKERS ARE NOT PRIMARY SOURCE OF INCOME FOR FAMILIES OR ARE YOUNG PEOPLE SEEKING FIRST JOB. NEVERTHELESS, FRENCH ADDED THAT SELECTIVE MEASURES SUCH AS "TRAINING CONTRACTS" AND EMPLOYMENT CREATION SUBSIDIES HAD BEGUN TO MAKE DENT IN UNEMPLOYMENT, AND THAT EFFORTS IN THIS AREA COULD BE INTENSIFIED WHEN SUFFICIENT PROGRESS TOWARD STABILIZATION WILL HAVE BEEN MADE (I.E. WHEN BARRE PLAN GOALS ARE REACHED).

8. CURRENT ACCOUNT: FRENCH PROJECT INCREASE OF 8 PERCENT IN THEIR EXPORT MARKETS AND 9.3 PERCENT GROWTH OF FRENCH EXPORT VOLUME. IN FRENCH VIEW (ALSO EXPRESSED BY DE LAROSIERE IN WP-3) GAIN IN MARKET SHARES IS PROBABLE IN 1977, SINCE FRANC HAD DEPRECIATED IN 1976 AGAINST CURRENCIES OF ITS MAJOR TRADING PARTNERS BY MORE THAN WOULD HAVE BEEN JUSTIFIED ON BASIS OF EVOLUTION OF RELATIVE COSTS. SPECIFICALLY, CORTESSE NOTED THAT FRENCH EXPORTERS WOULD BE PARTICULARLY WELL-PLACED VIS-A-VIS THEIR GERMAN COMPETITORS AS 20 PERCENT DEPRECIATION OF FRANC AGAINST DM IN 1976 WAS "EXCESSIVE" IN TERMS OF CHANGES IN RELATIVE COSTS. FRENCH ALSO OBSERVED THAT GOF FORECAST OF 8 PERCENT GROWTH IN EXPORT MARKETS HAD GREATER CHANCE OF MATERIALIZING THAN DID THAT OF SECRETARIAT, PARTLY IN VIEW OF ADDITIONAL STIMULATORY MEASURES PLANNED BY U.S. SECRETARIAT DID NOT INDICATE THAT IT WAS PREPARED TO REVISE ITS FORECAST OF 7.25 PERCENT GROWTH OF FRENCH EXPORT MARKETS AND STABILITY OF MARKET SHARES.

9. FRENCH EXPLAINED THAT SPECIAL FACTORS (E.G. DROUGHT,

ANTICIPATORY STOCKBUILDING), WHICH HAD ACTED TO INCREASE IMPORTS IN 1976, WERE NOT LIKELY TO BE REPEATED IN 1977, AND THAT VOLUME (7.1 PERCENT) GROWTH WOULD FOLLOW MORE "NORMAL" PATH LINKED TO GROWTH OF GDP. FRENCH ALSO NOTED THAT, ALTHOUGH PRECISE EVOLUTION OF TERMS OF TRADE LIMITED OFFICIAL USE

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IN 1976 (IN FRANCS) HAD NOT BEEN WORKED OUT, PRELIMINARY INDICATIONS ARE THAT DEPRECIATION HAD LARGE ADVERSE EFFECT ON CURRENT ACCOUNT BALANCE (E.G. 6 BILLION FRANC INCREASE IN COST OF OIL IMPORTS ALONE), AND EMPHASIZED THAT THIS FACTOR WOULD NOT OPERATE IN 1977 (SEE PARA 10 BELOW). GOF IMPORT FORECASTS ASSUME THAT FF55 BILLION LIMIT ON OIL IMPORTS IN 1977 WILL HOLD. (SECRETARIAT ESTIMATES FOR 1976 INDICATE THAT FRENCH DID NOT EXCEED FF51 BILLION CEILING.) FRENCH STATED THAT TO HOLD OIL IMPORTS TO TARGETED LEVELS, SUBSTANTIAL ECONOMY WOULD BE REQUIRED, AND INDICATED INTENTION TO IMPLEMENT ADDITIONAL CONSERVATION MEASURES IF NECESSARY DURING THE YEAR. SECRETARIAT AND FRENCH AGREED THAT 1977 CURRENT ACCOUNT DEFICIT WOULD BE IN \$3.5 - \$3.8 BILLION RANGE. NEITHER FRENCH NOR SECRETARIAT FELT THAT FINANCING OF DEFICIT WOULD PRESENT PROBLEMS THIS YEAR.

10. FRENCH EMPHASIZED THAT A PRIORITY OBJECTIVE FOR 1977 WOULD BE TO MAINTAIN STABILITY OF FRANC. (CALCULATIONS IN 1977 BUDGET ARE BASED ON FRANC/DOLLAR EXCHANGE RATE OF FF4.94 EQUALS \$1.00.) CORTESSE STRESSED THAT THIS GOAL WAS BOTH "DESIRABLE AND POSSIBLE" AND WOULD BE ACHIEVED BY HAVING PUBLIC ENTERPRISES BORROW ABROAD IN AMOUNTS EQUAL TO CURRENT ACCOUNT DEFICIT RATHER THAN BY OFFICIAL INTERVENTION. ALTHOUGH THEY REFERRED TO PM BARRE'S DIRECTIVE THAT PUBLIC ENTERPRISES WOULD SLOW DOWN THEIR BORROWING IN 1977, FRENCH WERE NOT ALARMED

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OPIC-03 SP-02 TRSE-00 CIEP-01 LAB-04 SIL-01 AGRE-00  
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-----242022Z 026645 /40

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OVER SHARP INCREASE IN EXTERNAL DEBT OF PUBLIC ENTERPRISES (FF21 BILLION RISE IN 1976). THEY EXPLAINED THAT NET DEBT (CREDITS MINUS DEBTS) HAD ONLY RISEN BY FF11 BILLION OVER LAST THREE YEARS, AND COMPARED THIS FIGURE WITH OFFICIAL RESERVES OF FF90 BILLION.

11. MONETARY AND FISCAL POLICIES: FRENCH STRESSED THAT MONETARY AND FISCAL POLICY WOULD BE IN FRONT LINE IN FIGHT AGAINST INFLATION AND IN EFFORT TO REDRESS CURRENT ACCOUNT POSITION. CORTESSE NOTED THAT BUDGET FOR 1977 HAD BEEN PRESENTED IN EQUILIBRIUM, AND THAT WHILE DEFICIT COULD APPEAR IN ACTUAL EXECUTION (E.G. BECAUSE OF REVISIONS IN PROFESSIONAL TAX AND POSSIBILITY OF ADDITIONAL INVESTMENT STIMULUS), IT WOULD BE FINANCED BY BOND SALES IN DOMESTIC MARKET AND THUS WOULD NOT DETRACT FROM GOF ABILITY TO KEEP GROWTH OF M2 WITHIN 12.5 PERCENT TARGET. IN ADDITION, FRENCH REITERATED ASSUMPTION THAT EXTERNAL SECTOR WOULD HAVE NEUTRAL IMPACT ON GROWTH OF MONEY SUPPLY, BUT NOT FOR REASONS ADVANCED BY SECRETARIAT IN REFD0C; I.E., FRENCH STATED LIMITED OFFICIAL USE

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THAT POLICY WILL BE TO HAVE PROCEEDS OF EXTERNAL BORROWING SOLD IN EXCHANGE MARKET. AS NOTED PARA 10 ABOVE, GOF EXPECTS TO GEAR EXTERNAL BORROWING OF PUBLIC ENTERPRISES TO SIZE OF CURRENT ACCOUNT DEFICIT TO HOLD VALUE OF FRANC STEADY. IN ESSENCE, FRENCH HAVE "DEFINED AWAY" POSSIBILITY THAT PUBLIC OR EXTERNAL SECTORS WILL HAVE ANY INFLUENCE ON MONETARY GROWTH. NEITHER SECRETARIAT NOR COUNTRY DELS PRESSED FRENCH FURTHER ON THESE QUESTIONS.

12. MAIN EDRC CONCLUSION WAS THAT GOF HAD TAKEN LARGE STEP IN RIGHT DIRECTION BUT WILL HAVE TO BE TOUGH OVER



TIME IN ORDER TO GET LASTING RESULTS.  
TURNER

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**Automatic Decaptioning:** X  
**Capture Date:** 01-Jan-1994 12:00:00 am  
**Channel Indicators:** n/a  
**Current Classification:** UNCLASSIFIED  
**Concepts:** ECONOMIC DEVELOPMENT, MEETING AGENDA, COMMITTEE MEETINGS, ECONOMIC REPORTS  
**Control Number:** n/a  
**Copy:** SINGLE  
**Sent Date:** 24-Jan-1977 12:00:00 am  
**Decaption Date:** 01-Jan-1960 12:00:00 am  
**Decaption Note:**  
**Disposition Action:** RELEASED  
**Disposition Approved on Date:**  
**Disposition Case Number:** n/a  
**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 22 May 2009  
**Disposition Event:**  
**Disposition History:** n/a  
**Disposition Reason:**  
**Disposition Remarks:**  
**Document Number:** 1977OECDP02305  
**Document Source:** CORE  
**Document Unique ID:** 00  
**Drafter:** n/a  
**Enclosure:** n/a  
**Executive Order:** N/A  
**Errors:** N/A  
**Expiration:**  
**Film Number:** D770025-0684  
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**Office:** ACTION EUR  
**Original Classification:** LIMITED OFFICIAL USE  
**Original Handling Restrictions:** n/a  
**Original Previous Classification:** n/a  
**Original Previous Handling Restrictions:** n/a  
**Page Count:** 9  
**Previous Channel Indicators:** n/a  
**Previous Classification:** LIMITED OFFICIAL USE  
**Previous Handling Restrictions:** n/a  
**Reference:** 77 STATE 9338, 77 OECD PARIS 819  
**Retention:** 0  
**Review Action:** RELEASED, APPROVED  
**Review Content Flags:**  
**Review Date:** 28-Feb-2005 12:00:00 am  
**Review Event:**  
**Review Exemptions:** n/a  
**Review Media Identifier:**  
**Review Release Date:** n/a  
**Review Release Event:** n/a  
**Review Transfer Date:**  
**Review Withdrawn Fields:** n/a  
**SAS ID:** 3521610  
**Secure:** OPEN  
**Status:** NATIVE  
**Subject:** ECONOMIC AND DEVELOPMENT REVIEW COMMITTEE (EDRC) REVIEW OF FRANCE  
**TAGS:** ECON, FR, OECD, EDRC, ECO & DEVEL REVIEW COMMITTEE  
**To:** STATE  
**Type:** TE  
**vdkgvwkey:** odbc://SAS/SAS.dbo.SAS\_Docs/a11b2bd2-c288-dd11-92da-001cc4696bcc  
**Review Markings:**  
Margaret P. Grafeld  
Declassified/Released  
US Department of State  
EO Systematic Review  
22 May 2009  
**Markings:** Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 22 May 2009